Help Identify the Best Stocks With These 3 Metrics

Description

It's not difficult to identify some of the best stocks out there. The first thing to notice is the long-term upward trend of their stock prices.

Stocks with price appreciation, which is backed by high returns on equity (ROE) and growing earnings per share, are safer investments than stocks that have appreciated a great deal, but have sky-high price-to-earnings multiples.

Since before the last recession, over a period of almost 10 years, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) stock has delivered about 10% per year, while **OpenText Corp.** (TSX:OTEX)(NASDAQ:OTEX) stock has returned nearly 20% per year. Here are some key metrics that support the fact that they're some of the best stocks to own over the long haul.

High and consistent return on equity

The ROE calculates how many dollars of profit a company generates with each dollar of shareholders' equity. It's a measure of a company's profitability and efficiency. Generally speaking, the higher the ROE and the more consistent it is, the better. Typically, a growing ROE is a good sign.

TD Bank's ROE has been 9% or higher every year since 2008 and 12% or higher every year since 2010. OpenText's ROE has been 8.6% or higher every year since 2008 and 11.1% or higher every year since 2010. Consistent, double-digit ROEs are a good sign.

Earnings-per-share growth

The earnings-per-share growth is another measure of profitability. In general, a higher growth rate is preferable over a slower one. For the risk-averse investor, it's safer to go for consistent growth rather than explosive growth because the latter isn't sustainable over the long run.

In the past decade, TD Bank increased its earnings per share in nine out of 10 years, while OpenText experienced earnings-per-share growth every year. Over the 10 years, TD Bank and OpenText boosted their earnings per share at a compound annual growth rate of nearly 6.8% and about 18.8%, respectively.

For a long-term portfolio, you want growth that would outpace inflation. The long-term rate of inflation is 3-4%. So, investors can aim for an average earnings-per-share growth rate of at least 8% to more than maintain their purchasing power.

Dividend-per-share growth

Not every great company pays a dividend, but if it does and also pays a sustainable, growing dividend, it'll simply add to its greatness. That's because dividends add to shareholders' overall returns and also force management to be more disciplined on their capital spending.

In the past decade, TD stock increased its dividend per share at a compound annual growth rate of 8.4%, while its payout ratio is about 47%. OpenText stock started a dividend in 2013. Its three-year dividend growth rate is 15.2%, while its payout ratio is about 21%.

Investor takeaway

Both TD and Open Text are reasonably priced at the recent quotations. They're some of the best stocks to own for the long haul, and it'll be a fabulous opportunity to build positions on meaningful dips. If you're looking for a dip, start considering TD stock at $66-72 per share and Open Text stock at $42-47 per share.

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1. Bank Stocks
2. Dividend Stocks

3. Investing
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TICKERS GLOBAL

1. NASDAQ:OTEX (Open Text Corporation)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:OTEX (Open Text Corporation)
4. TSX:TD (The Toronto-Dominion Bank)

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